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I Debt Problems Persist

Although high oil revenues have improved Iraq's debt servicing record and increased its access to new credits, Baghdad continues to reschedule most of its debt. Iraq's \$11.5 billion debt will continue to grow during the next several years as Baghdad seeks financing for reconstruction and civilian and military imports and will not reduce its debt until oil revenues increase significantly, probably not before the mid-1990s. Continued poor debt management would probably cause lenders to further restrict already limited credit lines to Iraq, forcing cuts in civilian spending and risking greater popular dissatisfaction with President Saddam Husayn's regime.

Iraq's inability to meet its financial obligations to creditors during the war led it to reschedule most of its debt, including short-term trade credits and interest payments. Large debt payments combined with low world oil prices precipitated a financial crisis in Iraq in 1986. Baghdad signed bilateral rescheduling accords with most of its creditors and ignored most other requests for payment. Iraq's poor payment record caused governments that had not already cut off credit lines to do so, forcing Iraq to scramble to pay for essential imports.

More Payments Bring More Credits

Higher oil revenues allowed Iraq to improve its debt servicing record somewhat in 1987-88. Baghdad's oil earnings of roughly \$11.5 billion last year were about 65 percent higher than in 1986 when its financial woes reached a crisis point. Even so, Iraq is paying most of its creditors only a portion of what they are owed—frequently just interest—and continues to reschedule the majority of its debt. Last year, Iraq rescheduled \$1.5-2.0 billion in debt due in 1987-89 and is seeking to reschedule several billion dollars more.

From Riches to Rags

Baghdad's extensive use of foreign loans since 1982 has transformed Iraq from one of the Third World's richest countries to one of its largest debtors. The accumulation of debt stems from Baghdad's decision to continue pursuing an ambitious economic development program despite the war with Iran. Civilian spending remained high while military expenditures increased and oil exports fell sharply because of Iranian-inflicted damage to oil facilities.

Baghdad gives repayment priority to creditors who provide more loans or supply goods and services vital to its economy. In contrast, some creditors, such as Japan, are receiving no payments at all. Baghdad has sought to repay its debt with oil whenever possible and negotiated such deals with Yugoslavia, India, and Turkey last year. The soft oil market, however, has discouraged most creditors from agreeing to barter deals.

In response to the worsening financial picture, Baghdad adopted domestic austerity measures and began borrowing from trading partners and its Gulf Arab allies in 1983. Iraq's foreign debt rose from \$5-6 billion—mostly short-term trade credits—before the war to roughly \$40 billion at yearend 1988. In addition, Iraq's Persian Gulf allies provided about \$36 billion in financial assistance—oil sold on Baghdad's behalf and cash transfers—during 1980-88.

We doubt Baghdad will repay this debt regardless of whether the Saudis and Kuwaitis formally cancel it.

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